

## **Change and resilience: Fund management in the new normal**

### **Keynote speech at HKIFA 14th Annual Conference**

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Good morning. It gives me great pleasure to be invited to the Hong Kong Investment Funds Association's (HKIFA) 14th Annual Conference to deliver this keynote speech.

If I remember correctly, this conference was originally scheduled for November 2020, but was unfortunately postponed as a result of the fourth COVID wave in Hong Kong. The fact that it is being held now is a great sign indicating a return to normalcy.

That said, I'm sure all of us would agree that the meaning of "normal" has been constantly evolving over the last two years. The pandemic has profoundly changed the way we have configured our work—not to mention our family and social life. Some of you are attending this conference in person while others may be attending virtually, in your own offices or even in the comfort of your own homes.

Perhaps one of the few positives to emerge from the unprecedented turmoil caused by COVID is that it gave us all a real-life opportunity to test the resilience of our market and the effectiveness of our business continuity plans—our "BCPs". Working from home and other alternative work arrangements have been around for some time now, but the pandemic has propelled us all in that direction. A hybrid approach to work and conferences will be the new normal going forward.

#### **The highs and lows of 2020**

Looking back, there is no doubt that 2020 stood out as a volatile year for markets. During March and April, fear of a pandemic-induced depression led to a severe liquidity crunch and a dash for cash globally. We saw the US circuit breaker being triggered multiple times, the VIX index hit a post-2008 high, oil futures prices plunge to the negative zone, a crash in high yield bond prices and a run on money market funds, to name but a few. On top of all this, Hong Kong was caught in the crossfire of Sino-US tensions over trade and technology and increasingly heated rhetoric about decoupling.

Notwithstanding geopolitical tensions or—perhaps somewhat ironically—driven by geopolitical tensions, there is now an active pipeline of US-listed Mainland firms returning to Hong Kong for secondary market listings. Total funds raised in Hong Kong increased 64% in 2020 and 172% in the first quarter of this year. Turnover in the Hong Kong stock market nearly doubled. There was similarly strong growth in the turnover for the Connect Schemes.

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Note: This is the text of the speech as drafted, which may differ from the delivered version.

Notwithstanding the rhetoric of decoupling, the Mainland capital markets are more integrated with the global markets than ever, creating opportunities that translated into record earnings last year for global and Mainland groups in Hong Kong performing that intermediary role. Hong Kong's asset and wealth management industry also delivered a spectacular performance: asset managers' annual net profits were up 72% and hedge funds' soared over 400%.

2020 will be remembered as a year where the lows were very low but the highs were also very high. In riding out the fastest GDP and market cycles ever, we should recognise that risks and opportunities always come hand in hand.

## Supervisory priorities

### A. *Operational and financial resilience*

Not surprisingly, the winners that emerged over the last year or so were the ones with the operational and financial resilience and robust risk management to navigate through the highs and the lows.

Our capital markets—including our licensed corporations and financial infrastructure—demonstrated strong resilience in the face of the pandemic and the dash for cash episode of March 2020. But the recent implosion of Archegos, the family office that defaulted on total return swaps' margin calls, serves as a reminder that a fund with outsized and concentrated bets could go from winning to losing overnight, triggering massive selloffs and leaving a trail of losses by prime brokers.

To mitigate the risk of such events happening here, we are enhancing our line of sight into the over-the-counter markets to identify any build-up of concentrated positions and stepping up our surveillance of prime brokers' activities in Hong Kong. A circular we issued almost exactly two years ago set out the standards of conduct we expect of prime brokers. This includes the risk management of their margin lending to investment funds<sup>1</sup>. Since then, we have been keeping a close watch on compliance through our ongoing supervisory tools and inspections.

We have also been keeping a close eye on fund managers' liquidity risk management and are about to wrap up a thematic inspection in this area. As a prelude, we reminded some firms to strengthen the robustness of their liquidity monitoring and controls in terms of stress testing, setting targets and assessing expected redemption patterns.

As we come out of the pandemic, financial firms are transitioning to a hybrid working arrangement for cost-saving and lifestyle reasons. It will be important for us to provide more guidance to firms on our expectations and share examples of good practices for remote work access, information security, BCPs and staff conduct, among other things, as these hybrid arrangements are likely to stay for a while.

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<sup>1</sup> See the SFC's 10 June 2019 [circular to intermediaries - prime services and related equity derivatives activities](#).

## *B. IPO-related misconduct*

It has been remarkable how COVID has accelerated changes in investor demographics and trading sentiment. Social media now has a much bigger influence on new entrants and day traders. We have seen a large increase in retail participation in our stock market and the number of client accounts at some of our online brokers has multiplied several times in a very short period.

There may be a variety of reasons for this. People spent more time online at home during lock-downs. Online trading applications are now more easily accessible. The fractionalisation of shares in the US allows people to trade in smaller amounts. Unfortunately, these conditions are fertile ground for scammers. Last year, the SFC received twice as many complaints about scams and frauds than the year before, and we have seen a sharp increase in scams conducted through social media platforms.

An increasing number of these scams involve companies newly listed in the past two years. In some of these listings, we found that unusually high commissions were paid to the underwriters and there is reason to suspect that this was done as part of arrangements to compensate controlled placees for creating a “market” or to subsidise their purchase of the shares at an inflated price. These are typical ways to artificially satisfy the initial listing requirements under the Listing Rules, such as the minimum market capitalisation.

The SFC is very concerned about these artificial arrangements. If the SFC suspects intermediaries to be associated with such schemes, we may prioritise them for more in-depth inspections. And if we see what look to be serious breaches or control deficiencies, we would promptly investigate them and would not hesitate to take enforcement action against misconduct related to initial public offerings (IPO) if necessary<sup>2</sup>.

As buy-side participants, you have an obvious interest in a clean, transparent and fair bookbuilding process. This is key to uphold the quality and integrity of the Hong Kong capital market. To promote higher standards of behaviour among those who arrange offerings, we recently proposed to clarify the roles played by intermediaries in equity and debt capital raisings and set out standards of conduct for book building, pricing, allocation and placing activities. The consultation period for commenting on these proposals has just ended and we are reviewing the responses now.

## *C. Green and sustainable finance*

With the pandemic, we can at least see a path back to normalcy. A less visible crisis—but one that is no less urgent—is the threat of climate change. Like COVID, this is also one of the defining issues of our time. The key challenge for the financial industry is to find a way to support a managed transition to a low carbon economy.

At the global level, the Sustainable Finance Task Force, a board-level committee of the International Organization of Securities Commissions that I lead as a Vice Chair, is exploring a pathway to making sustainability-related disclosures mandatory for corporates and asset managers. There are already a number of sustainability reporting standards out there, but these frameworks all differ in some respects—and they are entirely voluntary. This has

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<sup>2</sup> See the HKEX and SFC [joint statement](#) on IPO-related misconduct issued on 20 May 2021.

resulted in sustainability disclosures that can be inconsistent, and at times misleading. It can also lead to greenwashing.

At the moment, an effort is underway to establish a global sustainability reporting system that would resolve some of these issues. The IFRS Foundation has agreed to establish a sustainability standards board which will develop international standards for sustainability-related financial reporting. This is a very promising pathway to global convergence, given that 144 jurisdictions already use the IFRS accounting standards.

In a parallel development, there is now a lot of momentum for securities regulators to move forward with a phased approach to setting supervisory expectations for asset managers to integrate sustainability into their investment decisions. More investors now want to know to what extent their portfolios are financing emissions and how much their portfolios are exposed to climate risks.

We took a big step in this direction last October when we consulted on proposals to require fund managers to factor climate-related risks into their investment and risk management processes and make appropriate disclosures. Of course, we know full well that many fund managers are constrained by a lack of resources. So our proposed requirements give due consideration to the size of firms as well as the principle of proportionality.

#### *D. Wealth Management Connect and Hong Kong-domiciled funds*

Another priority for the SFC over the past year has been working closely with the Hong Kong Monetary Authority and Mainland authorities to prepare for the launch of the long-awaited Wealth Management Connect scheme. This promises to greatly expand sales of investment products to the Greater Bay Area (GBA).

I am happy to report that we are now in the home stretch. As a full-service asset management centre, Hong Kong has always been a distribution hub for funds domiciled in Cayman Islands, Luxembourg and elsewhere. Hong Kong can ride on this opportunity to expand as a fund platform, particularly now that fund managers have the option to set up open-ended fund companies (OFCs). There has been a strong pickup in interest in OFC applications for exchange-traded funds and other public as well as private funds, particularly after we announced the grant scheme<sup>3</sup>.

The long-awaited Wealth Management Connect Scheme opens up tremendous opportunities, but cross-border distribution to GBA residents will pose serious challenges for banks in Hong Kong. Banks here rely heavily on face-to-face means to solicit sales, but under this scheme, the mode would change to execution-only online platform and mobile apps. The Mainland's tech-savvy retail investors are used to a level of service that is very mobile, cost-effective and provides up-to-date fund information, and that would probably need to be matched to entice them to invest in authorised funds and products offered in Hong Kong.

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<sup>3</sup> The [Grant Scheme](#) for Open-ended Fund Companies and Real Estate Investment Trusts announced by the SFC on 10 May 2021 offers to reimburse 70% of eligible expenses paid, capped at HK\$1 million, for OFCs successfully incorporated in or re-domiciled to Hong Kong.



Covid has already put us on track for fund distribution to move online. Wealth Management Connect would just propel us more in that direction.

### **Conclusion**

As I said earlier, risks and opportunities go hand and hand. In the face of immense difficulties over the last two years, Hong Kong has shown exceptional resilience in adapting to unprecedented challenges. We are hopeful about a return to normalcy and we are seeing signs of that. But if we have learned anything, it is that change is the only constant, and we need to be prepared for the unexpected. So go green, go tech and stay resilient.

Thank you.